

VII. FIVE-YEAR FORECAST

Preparation of the five-year revenue forecast is complicated by economic uncertainty and the State's expanding budget problems. In more stable times, the forecast can assist decision-making by providing a longer-term perspective on potential results of budget decisions. In the current economic climate, which has been impacted by unprecedented events such as September 11, a five-year projection is less reliable. Uncertain economic conditions are overshadowed by the magnitude of the State's problems and the likelihood they will impact local government and render the results of an economic forecast useless.

Historical Information, Major Assumptions and Forecast Methodology

The forecast is for Fiscal Years 2002-03 through 2006-07. In the past, staff has prepared two possible revenue scenarios—conservative and less conservative. However, the specter of the still unresolved State budget crisis looming over the new fiscal year and the uncertain economic climate undermines the usefulness of an alternate scenario. Thus, a single revenue forecast is presented.

After two fiscal years (1997-98 and 1998-99) of essentially flat revenue growth, total revenues increased 21.8 percent by the end of Fiscal Year 2000-01. This was driven primarily by growth in sales tax that allowed the City to expand services in high priority areas such as Fire, Police, Library and Youth Services. However, during those years of limited revenue growth, it was necessary to control expenditures to maintain a positive financial position. The unpredictability of sales tax makes long-term revenue projections exceedingly difficult.

As discussed during the budget process, most of the Fiscal Year 2001-02 General Operating Fund revenue sources, except Property Tax and Use of Money and Property, were below budget. The General Operating Fund has a \$5.3 million operating balance for Fiscal Year 2001-02. Some of these funds are recommended for one-time expenditures and supplementing of reserves. This is drastically different from the \$21.4 million operating balance of the prior fiscal year and reflects the current poor economic climate. Though many economists have declared the nation is in a slow recovery, the local economy, which is driven by the high-tech industry, remains in a slowdown. Many dot-com businesses have failed, other companies have laid off employees and continue to do so, and business-to-business sales are very slow. A secondary effect of these conditions is significantly reduced business travel, which impacts transient occupancy tax. As a result, the forecast assumes slow growth into the future.

Projections of the major revenue sources are based upon and affected by the variables discussed below:

- Sales tax revenue is subject to economic, technological and political challenges, and local business decisions. Currently, the most significant challenges are the severe decline in the market value of technology companies over the past few years, lay-offs, the decline in business-to-business sales and the decline in consumer confidence and spending. During the 2001-02 fiscal year, electronic businesses generated approximately 29.0 percent of total recurring sales tax revenue. Any changes in reporting or decline in the sales of those companies have a direct impact on the City's sales tax revenue and its ability to provide services.
- Sales tax revenue has dropped sharply (30.7 percent) in the 2001-02 fiscal year after two prior fiscal years of growth. It is projected to increase marginally in Fiscal Year 2002-03 as staff and some economists believe this summer will be the low point for the region and will be followed by a slow recovery. Forecasting the multivariate factors that determine future levels of sales tax revenue is complex and largely conjecture. It is likely the future will not be a simple projection of historical trends. The importance of sales tax revenue to City finances and the difficulty of projecting future revenues argues for caution in interpreting the results of this forecast.
- Property tax revenue is impacted by real property prices, assessed valuation, ownership changes triggering reassessments, the level of development activity and the proportionate share of that activity to the rate of growth in the remainder of Santa Clara County. The recent assessed value reductions implemented by the County Assessor will have a dampening effect on the rate of revenue growth into the future until the value is restored to the current market value.
- Other Taxes:
 - Transient Occupancy Tax is impacted by the number of hotel rooms, the room rate and occupancy rate.
 - Utility Users Tax is dependent on the cost of energy, customer base and consumption levels.
- Investment earnings are based on the portfolio balance and yield.
- Licenses, Permits and Service Charges are primarily impacted by the level of development in the City.

Expenditures are trended based on historical experience assumptions about future growth rates using information gathered from various sources, extrapolations based on

the 2001-02 fiscal year, previously negotiated labor agreements and future costs of the adopted Fiscal Year 2002-03 budget. The expenditure forecast does not assume any additional programs, positions or service level enhancements beyond those currently included in the 2002-03 fiscal year adopted budget.

Conclusion

The General Operating Fund balance in Fiscal Year 2003-04 indicates a negative balance of approximately \$852,000, growing to \$8.6 million by Fiscal Year 2006-07 and does not include any reservation for the Economic Stabilization Contingency after Fiscal Year 2002-03. The funding gap may be exacerbated by State actions implemented to resolve its fiscal crisis. This projection highlights the continuing necessity of managing the City's expenditures and developing all possible revenue sources.

The forecast is updated annually as part of the budget process. Revenue trends are closely monitored and compared to expenditures in the preparation of the budget and each fiscal year appropriate budget proposals will be made based on projected revenues.

Included with this memo is a detailed presentation of the forecast summarizing, in graphic form, the revenues described above and the assumptions used to prepare the forecast.